Britain’s Co-op Bank teeters on the brink

Jean Shaoul
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The crisis at the UK’s Co-op Bank has been exacerbated by the release last month of video clips and text messages by the *Mail on Sunday* showing Paul Flowers, the former chairman of the bank, buying drugs and talking about paying for sex through a young male escort agency.

The bank is part of the Co-op Group. The Co-op is Britain’s largest and best-known mutual organisation, established in 1844, consisting of grocery stores, pharmaceutical shops, travel agencies, and funeral services, ostensibly run and owned by its members.

The Co-op branded itself as the “ethical bank”, making decisions on a long and not short term basis, and not investing in or providing loans to arms dealers, tobacco firms, sweat shops, etc. This is no longer viable.

Following hard on the heels of the transformation of the mutual building societies into stock market-listed corporations and/or their collapse in the wake of the global financial crisis, it demonstrates once again that the “not for profit” model, operating within the capitalist system, is no less exploitative of the working class than profit-driven corporations.

The Co-op’s crisis has, with considerable justification, caused Labour acute political embarrassment and threatens it with extreme financial difficulties. Since the publication of the November 23 *Mail* article, the Labour Party has suspended Flowers’ membership.

The decision to target Flowers, led by the Conservative Party-supporting *Daily Mail*, is a political one. The Co-op has long been associated politically and financially with the Labour Party. The Co-op’s financial resources have proved crucial to Labour in the past 20 years. As Labour’s basis of support and membership declined with its abandonment of its previous reformist programme, the party ran up huge deficits. It was the Co-op Group and the Co-op Bank that came to the rescue, providing cheap loans worth £34 million since 1993. Since 1999, Labour has had more than £18 million in “soft” loans from the Co-op Bank.

Flowers was formerly a Labour councillor in Rochdale, England from 1988 to 1992, and later in Bradford from 2001. He was accused of fiddling his expenses at the Lifeline Project, a charity where he served as a trustee, and having pornography on his council computer, prompting his resignation from Bradford council in 2011.

Flowers also became an advisor to Labour, having been appointed by party leader Ed Miliband to its Business and Industry Advisory Board in 2011.

His background and obvious lack of banking experience were not a deterrent to him being appointed director on the Co-op Group’s board in 2008, its deputy chair in 2009, director on the Bank’s board in 2008 or its chair in 2009. Under the Co-op’s arrangements, the 20-member board is elected by the 7.9 million owner-members of the group and the 80 independent societies. However, fewer than 250,000 members actually vote, allowing such decisions to be fixed by political insiders.

The Financial Services Authority (FSA) nodded the appointment through.

The bank’s position deteriorated drastically under Flowers’ watch. In the wake of the global finance crisis, the Co-op had aped its High Street peers and gone on a debt-financed buying spree. In August 2009, it had taken over another mutual, the Britannia Building Society with its 200 branches, more than tripling its size.

Despite other High Street banks’ disastrous experience of takeovers, the FSA and the Labour government never questioned the deal. Ed Balls, a Co-operative and Labour Party-sponsored MP, then at the Education Department and currently Shadow Chancellor, pushed for legislative changes to allow building societies and co-operatives to merge without demutualising, thereby enabling the bank to merge with the Britannia. In 2012, Balls accepted a £50,000 donation from the Co-op Group to the Labour Party to support his office.

The Co-op then moved in July 2011 towards another even bigger takeover, this time of 632 branches of Lloyds Bank. The government was seeking a buyer for part of the failed bank after the European Union (EU) demanded that Lloyds dispose of some of its branches in return for government support following its collapse in 2008-9. Despite FSA warnings that the Co-op bank did not have enough capital or the appropriate management skills to carry out the deal, the FSA allowed it to become the preferred bidder for the £750 million takeover in July 2012.

The Conservative-Liberal Democrat coalition is not immune from the escalating fallout. First, it too, after coming to power in May 2010, endorsed the 2009 takeover of Britannia, saddling the Co-op with billions of pounds of debt.

But crucially, a major factor in the FSA's failure to stop the Lloyds's takeover was Conservative Chancellor George Osborne's support for the deal. He reportedly leaned on the European Union to ease capital rules for the bank, stating that it would establish "a new banking system for Britain that gives real choice to customers and supports the economy" and "creates a new challenger bank and promotes mutuals". This was a key element in the Conservatives' coalition agreement with the Liberal Democrats.

Like all other banks, the Co-op also mis-sold payment protection insurance, leading to a £269 million bill for compensation. By April this year, with losses expected to top £700 million for the half-year and a £1.5 billion capital shortfall, the bank was facing bankruptcy and pulled out of the Lloyd's deal.

The Moody's credit agency responded by downgrading its rating to junk bond status. Some £1.6 billion of corporate deposits have since been withdrawn.

As a result of these disasters, Flowers resigned from the Co-op Group board in June this year and was eased out of the bank a few weeks later.

The Co-op Group's financial crisis has forced it into the arms of its bondholders in a last attempt to avoid collapse. These investors were two hedge funds, Aurelius Capital Management and Silver Point, who have links to the US Republican Party and the Tea Party groups. Aurelius was to have become Co-op Bank's largest hedge fund shareholder. Just prior to a November 29 vote on the deal, Aurelius dropped its interest and sold its Co-op Bank bonds to another hedge fund, Perry Capital. Perry Capital supported the deal crafted by Aurelius and Silver Point Capital.

Under the deal, the hedge funds become the new owners and will provide a £125 million cash injection. The Co-op Group will see its stake in the bank reduced to just 30 percent. 13,000 small investors stand to lose up to half the value of their £370 million bonds. Fifty of its 324 branches (15 percent) are to be closed, with the loss of at least 1,000 of its 9,000 banking staff, to make way for dividends and interest payments to the new owners.

If the plan fails, the Bank of England would have to step in. While the government guarantees small depositors up to £85,000, the bank's larger customers are not so protected. Financial consultants have advised their public sector clients–around 150 local authorities and schools bank with the Co-op–to pull out their deposits.

Flowers apparently didn't concern himself very much with the Co-op Bank's business during his tenure. When asked recently by the Treasury Select Committee how much the Co-op's assets were worth at the time of his resignation, he hazarded £3 billion. The real number was £47 billion. He had absolutely no idea of the value of the bank's loan book. He also overestimated a key capital ratio by a factor of two.

While the government has sought to extract every ounce of political capital out of the affair at Labour's expense, the reality is that Flowers' failings as a banker pale into insignificance when compared to many of his contemporaries–many close to and financially supportive of the Tories.

What has been revealed since the global financial crash of 2008 is that basic banking regulations were tossed aside, as the financial elite engaged in a frenzy of debt-based profiteering and speculative gambling to the tune of billions of pounds. Yet no one has been held accountable for anything.

In response to the Flowers revelations, a series of inquiries into the Co-op bank, a minnow by comparison, have been called that far exceed any into the biggest collapse in British corporate history, the Royal Bank of Scotland, or that of Lloyds, Halifax Bank of Scotland, Northern Rock and other banks and mutuals, who brought the economy to near-financial collapse.